4-17-2014

North Idaho Bldg. Contractors Ass'n v. City of Hayden Appellant's Brief Dckt. 41316

IN THE SUPREME COURT OF THE STATE OF IDAHO

NORTH IDAHO BUILDING CONTRACTORS ASSOCIATION, an Idaho non-profit corporation; TERMAC CONSTRUCTION, INC., an Idaho corporation, on behalf of itself and all others similarly situated; and JOHN DOES 1-50, whose true names are unknown.

Appellant,

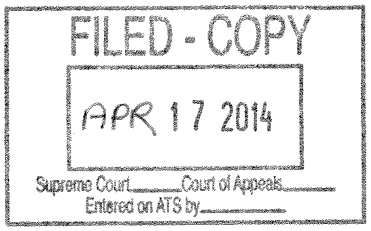
vs.

CITY OF HAYDEN, an Idaho municipality,

Respondent.

Supreme Court Case No. 41316

First Judicial District Court
Case No. CV-OC-12-02818



NORTH IDAHO BUILDING CONTRACTORS ASSOCIATION'S APPELLANT BRIEF

APPEAL FROM THE DISTRICT COURT OF THE FIRST JUDICIAL DISTRICT OF THE STATE OF IDAHO IN AND FOR THE COUNTY OF KOOTENAI HONORABLE BENJAMIN R. SIMPSON, DISTRICT JUDGE, PRESIDING

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PROCEDURAL NOTE CLARIFYING THE RECORD REGARDING DUPLICATE MEMORANDUM TITLES

The record in this matter contains two documents identically titled "Plaintiff's Response to Defendant's Motion for Summary Judgment" (R. Vol. II, p. 384-400), one filed on December 6, 2012, and the other filed on March 5, 2013. (R. Vol. III, p. 577-601). The initial brief was withdrawn and substituted with the latter. (R. Vol. I, p. 5, L. 5).

The initial brief was filed as a result of the Respondent attempting to have their Summary Judgment Motion heard before discovery could be conducted. This effort was denied by the trial court and discovery was allowed. After information was provided from the City, the Northern Idaho Building Contractors Association then substituted the initial brief with a more thorough and relevant response brief on March 15, 2013. The initial brief adds nothing of substance to the argument but the parties could not reach an agreement to remove it from the record, therefore this statement is provided to avoid confusion as to which brief is applicable.

I. STATEMENT OF THE CASE

A. Nature of the Case

The Appellant in this case is the North Idaho Building Contractors Association (hereinafter "NIBCA"), a trade association of local home builders and small businesses who are dedicated to keeping home ownership affordable. The Respondent is the City of Hayden, Idaho. This case is before the Supreme Court of Idaho to resolve the issue of whether or not a municipality may bypass the traditional infrastructure funding mechanisms and pay for the expansion of a new sewer system through mandatory "Capitalization Fees." The subject of the suit is a fee that is not related to any current sewer system, but instead is to be used to fund the construction of a new $20 million expanded system into the City of Hayden's area of impact. *(*R. Aug., p. 0023*)*. NIBCA maintains that, based upon Idaho Code and the litany of cases interpreting municipal authority, the law prohibits levying fees to raise revenue and/or pay for expansion into future use areas. The Respondent, the City of Hayden, has a differing interpretation, citing to the Idaho Revenue Bond Act and Idaho's user fee statutes as authority for their fee. The City's logic is flawed in that neither of these statutes allow the use of a fee for expansion.

B. Proceedings Below and Standard Upon Appeal

This case was decided in the lower court in part through Summary Judgment and thereafter through a Stipulation amongst the parties.

In an appeal from an order for summary judgment, the Court's standard of review is the same standard as that used by the district court in entering a motion for summary judgment. *Major v. Security Equipment Corp.*, 155 Idaho 199 (2013). Entry of summary judgment is appropriate if "the pleadings, depositions, and admissions on file, together with affidavits, if any,

show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law." I.R.C.P. 56(c). Disputed facts should be construed in favor of the non-moving party, and all reasonable inferences to be drawn from the record are to be drawn in favor of such non-moving party. *Fuller v. Callister*, 150 Idaho 848, 851 (2011). The Respondent was the party moving for Summary Judgment, therefore all inferences are to be drawn in favor of NIBCA.

C. Concise Statement of Facts

The factual issues in this case are generally not in dispute; rather, it is the application of the law where the parties disagree. It is undisputed that the City charges two fees in relation to its sewer system: one fee for the maintenance, operation, and replacement of the current system, and a separate fee used to fund future expansion. Hayden calls their maintenance and operation fee a "bi-monthly fee" and the expansion fee a "capitalization fee." (R. Vol. III, p. 641 ¶ 3). The bi-monthly fee is not at issue in this case.

The City also admits that the monies collected under the guise of the capitalization fees are planned to be used exclusively for future expansion. (R. Vol. I, p. 80). The City plans to use the capitalization fee to pay for its plan to bring sewer services out into virtually every part of the City's area of impact.

The lower court did find "significant disputed facts regarding the allocation and expenditure of funds collected from the city's capitalization fee." (R. Vol. III, p. 654 ¶ 2). However, the parties resolved these issues after the court's partial Summary Judgment decision. (R. Vol. III, p. 669-673).

Additionally, there is no factual dispute as to how the fees are collected; all parties agree they are mandatory fees imposed when one applies for a building permit within the city. The

City will not issue a building permit without payment of the capitalization fee and all other fees levied by the City. (R. Aug., p. 0038 ¶ 2).

It is also undisputed that the City's Sewer Capitalization Fee was assessed in 2001 at $580.00 per residential unit or its equivalent. The fee then increased in 2005 to $737.00, increased again in 2006 to $774.00, and yet again on June 7, 2007 to $2,280.00, a roughly 195% increase. (R. Vol. III, p. 636 ¶ 1).

II. ISSUES PRESENTED ON APPEAL

1. Did the court err in ruling that the Idaho Revenue Bond Act, Idaho Code § 50-1027 et seq., authorizes municipalities to collect sewer system "connection fees," which are to be solely used to pay for future expansion?
2. Did the court err in ruling that Idaho Code § 63-1311 authorizes municipalities to collect sewer system "user fees," which are to be solely used to pay for future expansion?

III. ARGUMENT

A. Introduction

This Court is being asked to uphold an illegal fee as a valid and appropriate way to fund future expansion and growth. In Idaho, cities can fund infrastructure growth through the issuance of bonds or through the implementation of Impact Fees. Idaho has enacted a very clear statutory scheme for cities to raise money for infrastructure necessitated by future growth pursuant to the Idaho Development Impact Fee Act ("IDIFA"), Idaho Code § 67-8201 et seq. The IDIFA contains very clear checks and balances so as to prevent a city from extracting an arbitrary amount from its citizens. However, by circumventing the IDIFA, the city of Hayden is doing exactly that and charging its arbitrary fee under the ruse of a user fee or an equity buy-in fee. Respondent cites the authority granted under Idaho Code § 63-1311 (user fees) and Idaho

Code § 50-1027 (equity buy-in fee) as justification for the City's capitalization fee. The difficulty with Respondent's argument, as illustrated herein, is that when the facts are applied to the case law interpreting these statutes it becomes apparent that there is no authority for the fee they have imposed.

In addition to the capitalization fee, the city of Hayden also imposes a significant impact fee and a bi-monthly sewer user fee, neither of which the Builders have challenged in this litigation.

B. Background of Unlawful Fee – No Relation to Current System

In March, 2006, the Respondent engaged an engineering and surveyor firm, Welch Comer & Associates, Inc. (hereinafter "Welch Comer"), to a report pertaining to the City of Hayden's Sewer Master Plan. This report calculates a fee which expands and implements Respondent's sewer master plan layout to service the entirety of Respondent's defined area of impact. Even the report itself calls the City's vision an "ambitious $20 million capital improvement plan." (R. Aug., p. 0041 ¶ 13.5.2). When this $20 million infrastructure expansion is fully implemented, Respondent will have sewer services reaching out into areas not even closely associated with any current or perceived development. See for example Welch Comer report page 2, page 17, and page 29-30. (R. Aug., p. 0008; p. 0023; p. 0034-0035).

On June 7, 2007, Respondent raised its self-defined "sewer capitalization fee" from $774.00 to $2,280.00 based solely on the analysis and report prepared by Welch Comer. (R. Vol. I, p. 114-15 ¶ 29). The raise in the "sewage capitalization fee" was to be used for "capital improvements needed to serve new growth, and updated cost and build-out projections." *Id.*

Despite the City's ordinance labeling this a "capitalization fee," counsel for Respondent repeatedly uses the term "capacity replacement." This phraseology is counsel's cleverly worded

term for expansion. It is clear that Respondent is just trying to justify expanding their system since this "replacement" theory is not supported by the Welch Comer report, which does not use the term "replacement," nor does it give any consideration to the current capacity of the system when calculating the fee. As stated *supra* in the Welch Comer report"[i]n order to finance this ambitious $20 million capital improvement plan, it is recommended that the City increase the sewer collection system capitalization fee." (R. Aug., p. 0041 ¶ 13.5.2). The report exposes how the sewage capitalization fee was really calculated by taking the capital improvement plan total of $20,416,900.00 and dividing it by the arbitrarily projected potential future population of Respondent. *Id.* Incidentally, there is no basis for the growth projection in the report. Welch Comer's report simply used numbers fed to it by the City. (R. Aug., p. 0023 ¶ 6.1).

C. The City's fee is not tied to the buy-in of a *current* system, but is used exclusively to raise revenue and therefore is not an equity buy-in fee.

The Idaho Revenue Bond Act in Title 50 of the Idaho Code authorizes the assessment of equity buy-in fees under the following conditions:

> [Any] city shall have the power under and subject to the following provisions...To prescribe and collect rates, fees, tolls or charges, including the levy or assessment of such rates, fees, tolls or charges against governmental units, departments or agencies, including the state of Idaho and its subdivisions, *for the services, facilities and commodities furnished by such works*, or by such rehabilitated existing electrical generating facilities, and to provide methods of collections and penalties, including denial of service for nonpayment of such rates, fees, tolls or charges.

I.C. § 50-1030(f) (emphasis added). Idaho Code § 50-1028 prohibits municipalities from operating works under the Idaho Revenue Bond Act as a primary source of revenue to the city. The term "works" is defined as, "water systems, drainage systems, sewerage systems, recreation facilities, off-street parking facilities, airport facilities and air navigation facilities, electric systems or any of them as herein defined." I.C. § 50-1029(a).

1. ***Loomis* provides a framework for municipalities to charge a lawful "equity buy-in" fee to a consumer connecting to an existing sewage system. Respondent's fee does not stand up to this scrutiny.**

In *Loomis v. City of Hailey*, 119 Idaho 434 (1991), the Court considered and refined the "equity buy-in" theory of charging connection fees under the Idaho Revenue Bond Act. An "equity buy-in" fee is based upon "the replacement value minus the remaining bond principal and cumulative unfunded depreciation." *Id.* at 436. This equity buy-in formula "allows the new user to buy into the [existing] system at the current dollar value [of the user's portion the system]." *Id.*

In further assessing the legality of the fee at issue in *Loomis*, this Court stated that the Idaho Revenue Bond Act authorizes the collection of sewer connection fees. The Court made it clear that if the fees collected pursuant to the Act are allocated and budgeted in conformity with that Act, they will not be construed as taxes. *Id.* at 439. In this regard, this Court has held that "a municipality may accumulate collected revenues from rates, charges or fees to fund the cost of replacement of system components in its public works projects which are *ordinary and necessary*" *Id.* at 440 (emphasis added); Idaho Const. Art. 8, § 3. The *Loomis* court went on to provide examples of expenses held *not* to be ordinary and necessary, such as "new construction or the purchase of new equipment or facilities" that stand in contrast to the "repair, partial replacement or reconditioning of existing facilities," which the Court found *were* ordinary and necessary. *Id.* (quoting *Asson v. City or Burley*, 105 Idaho 432, 441 (1983)).

The leading case in distinguishing whether an expense is "ordinary and necessary" is *City of Boise v. Frazier*, 143 Idaho 1 (2006). In *Frazier*, the Court held that the expansion of the City of Boise's airport's parking facility, although crucial to the operation of the airport, was nevertheless not an "ordinary and necessary" expense because the expansion could neither be

considered repair or maintenance. *Id.* at 5. Nor could it be "necessary," as the City could not cite a crisis, or even immediacy, regarding the expansion to be constructed within the next year; or, at today's build out rates, even over the next decade. *Id.* As a corollary, the Welch Comer report does not even state a projected date that the City could reach the projected population that would necessitate this new expansive sewer system.

Given the formula used by Respondent to establish its sewage capitalization fee, the fee cannot be considered an equity buy-in. No portion of the fee is used for maintenance, repair, or upkeep of the existing system (the City has a bi-monthly fee to cover that), and the fee has no relation to the value of the existing system. It was calculated by considering the cost of Hayden's "wish list" of future capital improvements and dividing it by the number of future users the future system may someday serve. Its sole purpose is to raise revenues for the future expansion of Respondent's sewer system.

2. The lower court's reliance on *Viking* was in error, as it is distinguishable from Respondent's sewage capitalization fee because the Idaho Revenue Bond Act prohibits operating works primarily as a source of revenue.

The lower court and the Respondent assert that the holding in *Viking Construction v. Hayden Lake Irrigation District*, 149 Idaho 187 (2010), authorizes Respondent to assess its sewage capitalization fee without regard to the existing sewage system's value or the lack of equity calculations. In *Viking*, the Hayden Lake Irrigation District charged a fee to connect to its domestic water distribution system. *Id.* at 190. A portion of the connection fee covered the actual cost of connecting to the water system, but the majority of the fee was intended to be the cost of buying an equity interest in the system. *Id.* The *Viking* court held that a portion of this fee may also be used "to provide a reserve for improvements to their works." *Id.* at 197 (citing I.C. § 43-

1912(e)). It would be difficult from the plain meaning of "improvement" to consider a $20 million assessment used to triple the system capacity as an "improvement."

In addition, the most important precedent articulated in *Viking* is that the taxing district must base all equity buy-in fees upon specific factual findings and calculations:

> However, for the connection fee to be an equity buy-in, it must be based upon some calculation designed to determine the value of that portion of the system that the new user will be utilizing. If there is no attempt to calculate in some manner that value, then the connection fee is not an equity buy-in regardless of its label.

Id. at 194. The facts of the case at hand are also notably different than those presented in *Viking* especially in one distinct way: The *Viking* case involved a fee that was intended to be the cost of buying an equity interest in the *existing* system, whereas Respondent's sewer capitalization fee is solely intended as a revenue raising mechanism to provide funding for capital expenses for the community in the future. Respondent's study focuses on funding "capital improvements that must be replaced, enlarged or reconfigured so that system capacity continues to be available for *future users*." (R. Vol. I, p. 114 ¶ 26) (emphasis added). By Respondent's own admission, Respondent's study is not based on "the value of that portion of the system that the new user will be utilizing" as required by *Viking,* but rather is a revenue raising mechanism to perform capacity expansion projects.

Thus, although there may have been an incidental collection of fees reserved for improvement of the system in *Viking*, Respondent's sewage capitalization fee is assessed *solely* as a revenue raising mechanism. Under the Idaho Revenue Bond Act, municipalities are prohibited from operating works primarily as a source of revenue to the city, which is exactly what Respondent is doing. Just because that revenue is earmarked to build future sewer works, as opposed to street or other works, does not save the illegal fee.

D. The City's fee is not related to any service being rendered and therefore is not a user fee.

1. City's capitalization fee is not a user fee.

The City's tries to justify its capitalization fee citing support from Idaho Code § 63-1311, which allows municipalities to charge a fee for the use of a particular service (a "user fee"). The lower court also used this Code section to uphold Respondent's fee:

> Notwithstanding any other provision of law, the governing board of any taxing district may impose and cause to be collected fees for those services provided by that which would otherwise be funded by property tax. The fees collected pursuant to this section *shall be reasonably related to, but shall not exceed, the actual cost of the service being rendered.*

I.C. § 63-1311(1) (emphasis added). There is a well-developed body of case law interpreting the above cited section of Code. These cases have produced tests to aid in analyzing whether or not a fee is a permissible user fee, or if it is merely a disguised tax. The tests look to the relationship and cost between the fee and the service being provided.

This Court considered a fee very similar to Respondent's fee in the case of *Brewster v. City of Pocatello*, 115 Idaho 502 (1988). In this case, this Court was analyzing a "street fee" imposed upon property owners. The Court found that "the revenue to be collected from Pocatello's street fee has no necessary relationship to the regulation of travel over its streets, but rather is to generate funds for the non-regulatory function of repairing and maintaining streets." *Id.* at 504. Further, the Court stated "[i]n a general sense, a fee is a charge *for a direct public service rendered to the particular consumer, while a tax is a forced contribution by the public at large to meet public needs.*" *Id.* at 505 (emphasis added).

As demonstrated *supra*, for the City's fee to withstand the scrutiny under the tests established in *Brewster*, the City needs to attribute the fee back to a service being provided. The

City absolutely cannot meet this test. As mentioned previously, the fee imposed was derived directly from the Welch Comer Report. The Welch Comer report did not consider the cost or the remaining capacity of the existing system whatsoever when setting the fee; it merely looked into the City's wish list of building a $20 million infrastructure into undeveloped areas of impact. (R. Aug., p. 0041-0042). The City argues that the fee is for a "system capacity replacement cost." (R. Vol. I, p. 71-107). The lower court also bought into this argument. (R. Vol. III, p. 643). However, there are no facts to back up the City's creative labeling of this fee.

The capitalization fee at issue stands in stark contrast to the City's "bi-monthly" fee. The bi-monthly fee actually is a user fee; it provides money for the maintenance, operation and replacement of the current sewer system:

> There is hereby established a system of periodic service charges and fees in order to equitably impose upon all users of public sewerage systems the cost and expenses of maintenance, operation, replacement and other expenditures of this sewerage system. Said services charges and fees for purposes of computation shall be based upon: (a) the volume and contact of the fluent discharged into the sewerage system of the city; and (b) the actual and expected costs and expenses of maintenance, operation, replacement, upgrading and repair of the sewerage system, such charges and fees being determined to be the benefit derived by each building, structure or user of the collector system and regional facility.

Hayden City Code 8-1-4. As one can see from the plain language of the ordinance, this fee is directly tied to the actual and expected costs and expenses of maintenance, operation, replacement, upgrading, and repair of the sewer system services rendered directly to the customer. Thus, the bi-monthly fee is a permissible user fee. Monies from that user fee maintain the collector pipes, the mains, and the lift stations, all of which are being currently used by the customers who pay the fee for its maintenance. A customer paying this fee benefits directly by discharging its sewer into the system, which is obviously a direct benefit.

It is hard to see how any customer in the currently developed area of the city would receive any benefit from proposed collector pipes, mains, and lift stations located out in the far reaches of the city's area of impact, where there is currently little-to-no development.

The lower court believed that Respondent's fee was a user fee based upon its analysis of *Alpert v. Boise Water Corp.*, 118 Idaho 136 (1990) and *Kootenai Property Owners Association v. Kootenai County*, 115 Idaho 676 (1989), discussed *infra*. As demonstrated below, the lower court's analysis under these cases is in error.

2. *Alpert v. Boise Water Corp.* distinguished.

Alpert v. Boise Water Corp., supra, is a franchise fee case and does not pertain to the same area of law present in this case. Even Respondent realized the distinction in prior briefing: "[T]hat exaction by the city is legitimate not because it is a user fee, but for reasons unique to franchises that have no bearing on the present litigation." City's Opening Brief in Support of Motion for Summary Judgment, (R. Aug., p. 0041-0042). Nevertheless, the dicta Respondent relies upon refutes its argument more than bolstering it:

> "As noted in *Brewster*, the providing of sewer, water, electrical and other utility services to residents *based on consumption of the commodity* is a charge for a *direct public service* as compared to a tax which is a forced contribution by the public-at-large for revenue raising purposes."

Alpert, 118 Idaho at 145 (emphasis added). Respondent's fee makes no attempt to link to a payer's consumption in the current system. Rather, the fee is calculated based on the estimated costs for future capital improvement projects to Respondent's sewer system divided by the estimated amount of future users. (R. Aug., p. 0041-0042). The fee goes to fund projects that are in no way associated with the payer. Instead, the revenues are used to fund projects located throughout the city that will be used to expand the capacity of the city's sewer system that will

benefit future system users. It is undisputed that Respondent's "sewer capitalization fee" raises revenues that are used exclusively on capital improvement projects. Deposition of Stefan Chatwin, pages 28:17 through 29:9 (R. Volume III, p. 574).

Respondent's fee is strictly a revenue raising measure to raise funds to expand the existing sewage system to provide infrastructure that is of a common benefit to the community and therefore, it is a tax. The Welch Comer report recognized this to be a tax, even stating "these elements of the City's sanitary sewer system are considered infrastructure, which is of a common benefit to the community." (R. Aug., p. 0040 ¶ 1).

3. *Kootenai Property Owners Association* is inapplicable to the case at hand.

Respondent convinced the lower court that *Kootenai County Owners Assn. v. Kootenai County, supra,* justified its fee. However, the Court and Respondent inappropriately rely on this case, as the *Kootenai County* Court was not considering or applying Idaho Code § 63-1311. Rather, the Court applied a completely different statute, Idaho Code § 31-4403, which pertains to landfill sites and gives the commissioners a statutory duty to "acquire sites." *Kootenai County,* 115 Idaho at 678–679. Further, the Court explained that "[t]he basis upon which the ordinance in *Brewster* was overturned – that it lacked specific legislative authorization – is not present here." *Id.* at 680.

Respondent argued before the trial court that the authorization in Idaho Code § 63-1311(1) is even broader than the one that was sufficient to uphold the user fee in *Kootenai County Owners Association.* (R. Vol. III, p. 614 ¶ 5). On the contrary, Idaho Code § 63-1311(1) only permits charging a fee that is "reasonably related to, but shall not exceed, the actual cost of the service being rendered." As established *supra,* Hayden's fee is based on the costs of a series of future capital improvement projects and has no reasonable relation to the services being

rendered to the current particular consumer. Were Respondent's interpretation of Idaho Code § 63-1311(1) to be adopted, there would be no such thing as an impermissible fee, since municipalities would be allowed to charge any fee they desired so long as it was loosely tied to some government function. Such an interpretation is quite contrary to the Court's holding in *Brewster* and all other case law applicable to municipal taxing authority.

Respondent's capitalization fee fails when analyzed against the test established in *Brewster* that asks if the fee is a charge for a direct public service rendered to a particular customer. The fee is only tied directly to a future sewer system envisioned by the City, which the current customer cannot even use. The fee is a tax used to meet the needs of the public at large and is thus impermissible.

IV. REQUEST FOR COSTS

NIBCA does not request attorney's fees, but requests an award of costs incurred in this appeal pursuant to I.A.R. 40.

V. CONCLUSION

In conclusion, NIBCA respectfully requests this Court void the City's illegal fee as it has no basis in Idaho law, either as an equity buy-in fee or a user fee.

Respectfully submitted this 17th day of April, 2014.

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JASON S. RISCH

CERTIFICATE OF SERVICE

I hereby certify that on the 17th day of April, 2014, I caused to be served a true and correct copy of the foregoing **APPELLANT BRIEF** as follows:

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